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THE DODD-FRANK ACT

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ECONOMIC POLICY ANALYSIS – ECO 315
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INTRODUCTION

The purpose of this paper is to explain and analyze the sweeping regulatory legislation known as “The Dodd- Frank Wall Street Reform and Consumer Protection Act of 2010,” commonly known as the Dodd-Frank Act.¹ In the wake of the financial crisis of 2007-2009, which shook the economy and plunged it into a deep recession, it became apparent that the framework of the financial regulatory system was not only in need of repair work, but in some places significant restructuring.² In recognition of the failings of the financial regulatory environment, the United States government responded with the Dodd-Frank Act to restructure the regulatory system as well as restore market and consumer confidence.³

In this paper I will discuss the major objectives of the act and address a few challenges the policy faces in its attempt to restructure the financial regulatory system. At the heart of these objectives is the need to repair the financial regulatory system so that it can better provide financial stability to the overall economy. The challenge presented to regulators is deciding which of the goals of a good financial system to focus on.⁴ Innovation and competitiveness would be better accomplished with less regulation whereas safety and soundness are better guaranteed with stricter regulations.⁵ The choices policy makers and regulators must make will depend on what they value more.⁶

The objectives of the Dodd-Frank Act are “to promote financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too-big-to-fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices,

¹ “The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,” United States Government Printing Office, Washington, D.C. (2010). (PDF version).

² Matthew Richardson, “Regulating Wall Street: The Dodd-Frank Act,” *Economic Perspectives* no. 3 (2012): 85. Matthew Richardson is a chaired professor at the Leonard N. Stern School of Business at New York University.

³ Zsuzsánna Biedermann, “The History of American Financial Regulation,” *Public Finance Quarterly* 57 no. 3 (2012): 324.

⁴ Viral V. Acharya, Thomas F. Cooley, Matthew P. Richardson, and Ingo Walter, *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (Hoboken: Wiley, 2010).

⁵ Ibid.

⁶ Robert E. Krainer, “Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance,” (Review), *Journal of Financial Stability* 8 no. 2 April (2012): 122.

and for other purposes.”⁷ First, in this paper I describe how the act plans to address these objectives by restructuring the financial regulatory framework and setting in motion regulations designed to improve the stability of the overall financial system. Second, I will discuss a few of the market failures that exacerbated the financial crisis and contributed to the damages the nation is still trying to recover from. Third, I will discuss some of the market and government failures that will continue to challenge the financial regulatory system. Fourth, I will present a few recommendations for consideration.

HISTORY OF FINANCIAL REGULATION IN THE UNITED STATES

The Dodd-Frank Act aims to restructure financial regulation in response to the events of the financial crisis of 2007-2009. In order to put Dodd-Frank into an understandable context it is important not only to understand the events that led up to the crisis but to also understand some of the changes that have been made over time to financial regulation in America. First, in response to the Panic of 1907, where a liquidity crisis swiftly turned into a solvency crisis, Congress passed the Aldrich-Vreeland Act which examined possible solutions to address the need for emergency capital.⁸ Three years later, based on the recommendations set before Congress from the Aldrich-Vreeland report, Congress enacted on December 22, 1913 the Federal Reserve Act, thereby creating the Federal Reserve System with powers to expand credit and currency.⁹

Second, in the aftermath of the stock market crash of 1929 Congress enacted the U.S. Banking Act of 1933, commonly known as the Glass-Steagall Act. The intention of this bill was “[t]o provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes.”¹⁰ It separated commercial (deposit-taking and lending) from investment (underwriting and trading business) banking.¹¹ One of the market failures that the Glass-Steagall Act addressed was moral hazard, as Biedermann helps

⁷ “The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.”

⁸ Richardson, 91.

⁹ Ibid., 91.

¹⁰ The Glass-Steagall Act of 1933. New York Federal Reserve. (PDF version).

¹¹ Krainer, 122.

to explain: “[t]he Act was meant to prevent banks from drifting near bankruptcy by foolhardily risking clients’ money, since if a bank catering to small depositors is having liquidity troubles; the state often undertakes to help out financially in order to protect the interests of the aforementioned small depositors.”¹² According to Robert E. Krainer, “[w]here the [Glass-Steagall Act] broke down was in the regulatory capture following the oil shocks of the 1970s and early 1980s which in turn resulted in high inflation and interest rates and facilitated the growth of shadow banks in the form of money market mutual funds.”¹³ Shadow banks did not accept deposits; therefore they were not considered traditional banks and were therefore not subject to regulation.¹⁴

Third, after years of contention over deregulation between Washington and the financial industry the Gramm-Leach-Bliley Act (also known as The Financial Services Modernization Act) was signed into law on November 12, 1999 by President Bill Clinton.¹⁵ The legislation effectively repealed the two “anti-affiliation provisions” of the Glass-Steagall Act of 1933 that separated commercial from investment banking and also brought an easing to the overall financial regulatory environment.¹⁶ It cleared the way for the creation of financial conglomerates, which some felt were needed to be competitive globally.¹⁷ Commercial banks, investment banks, securities firms, and insurance companies were allowed to merge, eventually becoming known as “too big to fail” financial institutions.¹⁸ However, these conglomerates built themselves up, constituting moral hazard because they were secure in the knowledge they were so systemically important that the government would not let them fold.¹⁹

¹² Biedermann, 313.

¹³ Krainer, 122.

¹⁴ Investopedia US, A Division of ValueClick, Inc. "Investopedia."

¹⁵ Biedermann, 314.

¹⁶ Douglas J. Elliot, “Structuring Finance to Enhance Economic Growth and Stability.” *Brookings Institution* (2013): 1-18.

¹⁷ Biedermann, 315.

¹⁸ *Ibid.*, 314.

¹⁹ *Ibid.*, 315.

FINANCIAL CRISIS OF 2007-2009

In order to evaluate the Dodd-Frank Act it is also important to understand the events and market failures that led to the global financial crisis of 2007-2009. What went so wrong that necessitated legislation to change the way the regulatory system worked? Legislation that has the potential not only to change the way the financial industry does business, but also could have long-lasting effects on the economy.

Robert M. Solow begins the tale by explaining a “modern capitalist economy with a modern financial system could probably adapt to minor shocks—positive or negative—with just a little help from monetary policy and mostly automatic fiscal stabilizers”; however, “that same financial system has intrinsic characteristics that can make it self-destructively unstable when it meets a large shock.”²⁰ These characteristics that Solow refers to are a series of market failures that contributed to a perfect storm that brought the financial system into a state of crisis. Solow describes these two major sources of market failures as asymmetric information and systemic risk.²¹

First, asymmetric information allowed some market participants to know things that others did not, adding to an imbalance in the structure of securities that were so “complicated and opaque” that almost no one in the market understood the implications.²² Furthermore, insiders had an exploitable advantage and incentive to turn their knowledge into profit.²³ Second, systemic risk was created by huge financial institutions raising incredible sums of credit in ways that endangered the whole system, “without anyone taking account of, or feeling responsible for, the system wide effects.”²⁴ It was this combination of conditions that set the stage for a great fall. Another key actor in the financial crisis of

²⁰ Robert M. Solow, “How to Understand the Disaster,” *The New York Review of Books* 56 no. 8 (2009). 1987 Nobel laureate.

²¹ Ibid.

²² Ibid.

²³ Ibid.

²⁴ Ibid.

2007-2009 was the principal role of leverage, which “turns large banks and financial institutions into ninepins that cannot fall without knocking down others that cannot fall without knocking down still others.”²⁵

With the goal of mitigating risk by diversifying investment portfolios, asset-backed mortgages with varying degrees of risk were being bundled into securities and sold as investment instruments. This popular strategy, known as securitization, was “intended as a way to transfer credit risk to those better able to absorb losses, but instead it increased the fragility of the entire financial system by allowing banks and other intermediaries to ‘leverage’ up by buying one another’s securities.”²⁶ Basically the financial industry was involved in one enormous carry trade, where one can purchase investments that yield a higher rate of return than it costs to borrow the funds.²⁷

As the financial crisis unfolded it became obvious that numerous financial institutions were doing the exact same thing: they had all leveraged themselves into dangerously vulnerable positions to make risky investments.²⁸ With the start of the housing market decline, the collateral backing these assets became toxic.²⁹ So begins the downward spiral, as Robert M. Solow explains:

All those banks and others [that are highly leveraged and stuck with toxic assets of uncertain value] are now unwilling to lend to one another because they fear that the potential borrower is already broke and will be unable to repay. And so the credit markets freeze up and ordinary businesses that need credit for ordinary business purposes find that they cannot get it on any reasonable terms. This is what happened in September 2008 when the commercial paper market—the market for daily business borrowing—ceased to work. The breakdown of the financial system exacerbates the recession; many who want to buy or build cannot get credit with which to do so. The recession then endangers the solvency of more financial and nonfinancial borrowers and worsens the state of the financial system.³⁰

The events that occurred during the financial crisis led Washington and its policy makers to respond with a sweeping regulatory system overhaul. At the bottom of the business cycle, they were forced to

²⁵ Ibid.

²⁶ Anne M. Khademian, “The Financial Crisis: A Retrospective,” *Public Administration Review* November/December (2011): 843.

²⁷ Frederic S. Mishkin, “Over the Cliff: From the Subprime to the Global Financial Crisis,” *Journal of Economic Perspectives* 25 no. 1 (2011): 55.

²⁸ Solow.

²⁹ Ibid.

³⁰ Ibid.

recognize the system's failures and respond with much stricter rules which tend to be costly to comply with. If this is the response at the bottom of a business cycle, what happens at the top?

Enter stage right, a villain in this tragedy known as Cyclical Euphoria. According to Raghuram G. Rajan there were many to blame for the financial crisis of 2007-2009. However, he points to the top of the business cycle and the euphoria generated by the "prosperity and growth of a boom" as the main culprit.³¹ Chuck Prince, chairman of Citigroup said: "When the music stops, in terms of liquidity, things will be complicated. But, as long as the music is playing, you've got to get up and dance. We're still dancing."³² In a sense, all the players were caught up in the music and nobody was willing to stop and think about it ending. Rajan further illustrates his point by stating:

Politicians have an incentive to ride the boom, indeed to abet it, through the deregulation sought by bankers. After all, bankers have not only the money to influence legislation but also the moral authority conferred by prosperity. And what of regulators? When everyone is 'for' the boom, how can regulators stand against it? They are reduced to rationalizing why it would be technically impossible for them to stop it. Everyone is therefore complicit in the crisis because, ultimately, they are aided and abetted by cyclical euphoria.³³

The business cycle plays an undeniable role in the course of all financial activity. It is a process that repeats itself, moving from top (booms) to busts (bottom) and back up again. Depending on where the market is, in relation to the business cycle, will affect policy decisions because of the pressure put upon policy makers to either provide safety and stability or allow innovation and competitiveness.³⁴

DESCRIPTION OF THE DODD-FRANK ACT OF 2010

³¹ Raghuram G. Rajan, "The Credit Crisis and Cycle-Proof Regulation," *Federal Reserve Bank of St. Louis Review* September/October (2009): 397. Raghuram G. Rajan was the Eric Gleacher Distinguished Service Professor of Finance at the Booth School of Business, University of Chicago and is currently the Governor of the Reserve Bank of India.

³² *Ibid.*, 399.

³³ Rajan, 400. Quoted Chuck Prince.

³⁴ Acharya et al.

The act begins with a short list of goals: “an act to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”³⁵ The act is immense and far-reaching, consisting of 2,319 pages, covering 16 titles, and now including over 243 (and counting) rules that stem from 11 separate government agencies. The act is considered to be an ambitious and momentous effort to remake the financial sector; its impact is felt not only by every part of the financial industry but also by all corporations and consumers as well.³⁶

Some of the most noteworthy changes pertaining to the act’s aim of improved oversight and concern over systemic risk are (1) the creation of a new council, the Financial Stability Oversight Council (FSOC) to give regulators new monitoring and resolution authority, (2) changes to the Federal Reserve, including an added mandate to provide financial stability, and (3) the creation of a new Bureau of Consumer Financial Protection.³⁷ To date the act is only partially in effect because some rules have yet to be completed and implemented. The act’s effectiveness continues to be contested strongly not only by politicians, financial industry leaders and an active, well-financed lobby, but also by economists and academics. Some are afraid the act goes too far, yet others argue it does not go far enough and will not protect against another financial crisis. Proponents believe the new rules will help prevent another crisis, whereas detractors argue that the act will slow future economic growth.³⁸

Simply put, the conflict in opinion stems from an inability to achieve all the fundamental goals for a sound financial system at the same time. Without a doubt difficult choices have to be made.

According to the authors of *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* there are four basic goals for a good financial system: (1) Encourage innovation and

³⁵ “The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.”

³⁶ Khademian, 841.

³⁷ William Sweet, “Dodd-Frank Act Becomes Law,” *The Harvard Law School Forum on Corporate Governance and Financial Regulation*, (2010).

³⁸ Steven J. Markovich, “The Dodd-Frank Act,” Council on Foreign Relations (July 2012).

efficiency; (2) provide transparency; (3) ensure safety and soundness; and (4) promote competitiveness in global markets.³⁹ Robert Krainer, in his review of *Regulating Wall Street* agreed and pointed out that “[o]bviously these conditions cannot be satisfied simultaneously and the choices that will be made will depend on the weight given to each of the four by regulators at a given point in time. For example, at present regulators put a heavy weight on safety and soundness and this could compromise the criteria of innovation and global competitiveness.”⁴⁰ Imagine a scale, one side represents safety and soundness and the other side innovation and competitiveness. I would argue that it is important to strive for balance among these goals to provide an environment that is safe, yet still encourages growth and competition. Regulations should not be so strict that it prohibits market activity nor should it be so loose that market activity has the potential to bring financial chaos.

In the following section I discuss how the Dodd-Frank Act addresses the underlying causes of the crisis by modernizing the regulatory framework as well as examine some further challenges that still face us.

ANALYSIS OF MAJOR OBJECTIVES

First, in this section I describe how the Dodd-Frank Act plans to address its objectives by restructuring the financial regulatory system and to set in motion regulations designed to improve stability of the financial marketplace, as well as to address the issue of systemic risk. I also discuss in greater detail the intention of the act to correct perceived failures and to highlight some of the challenges in achieving the act’s stated goals. Second, I discuss the impact the act has had on the economy thus far. Third, I discuss the challenges that will continue on despite the efforts of regulatory reformation.

Promote the Financial Stability by Improving Accountability and Transparency in the Financial System: At the heart of the objectives of the Dodd-Frank Act is the desire to promote a safe and stable financial system. The major market failure that came into the spotlight during the financial crisis was

³⁹ Acharya et al.

⁴⁰ Krainer, 122.

systemic risk and how it endangered the financial industry and the whole American economy. In order to achieve this goal, not only must the act address issues that affect the overall system but also individual firms, therefore necessitating the need for macro- and microprudential regulation. From the macroprudential prospective the act addresses the need for financial stability (1) with the creation of a new consultative group of financial regulators, and (2) by reforming the Federal Reserve.

First, as Robert Krainer explains, “the Dodd-Frank solution to the problem of systemic risk relies on the judgment of wise men and women...this wise judgment takes the form of creating a Financial Stability Oversight Council” (FSOC).⁴¹ The FSOC has 10 voting members (who provide the expertise of federal and state regulators, plus an insurance expert) and five nonvoting members (who serve in an advisory capacity only).⁴² It is the FSOC’s responsibility to detect emerging risks that have the potential to threaten the financial system and its stability and to encourage market discipline.⁴³ In support of the FSOC’s role the act also created another new agency, the Office of Financial Research (OFR) under the auspices of the Department of the Treasury. This new agency is responsible for collecting financial data and conducting economic analysis for the FSOC.⁴⁴ Financing for this research center will come from fees assessed on systemically important financial companies (SIFIs).⁴⁵

The FSOC has the authority to “make recommendations about appropriate macroprudential regulation, to collect information about market activities, and to designate systemically important institutions or activities that will come under the oversight of the Federal Reserve as the systemic risk regulator.”⁴⁶ The Council’s format brings together key regulatory agencies in a manner as to contribute to public policy. Their powers include:

⁴¹ Krainer, 123.

⁴² Douglas D. Evanoff and William F. Moeller, “Dodd-Frank: Content, Purpose, Implementation Status, and Issues,” *Economic Perspectives* 3Q (2012): 77.

⁴³ Ibid., 77.

⁴⁴ United States Senate Committee on Banking, Housing & Urban Affairs, Brief Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010).

⁴⁵ Krainer, 124.

⁴⁶ Evanoff and Moeller, 77.

- Making “recommendations to the Federal Reserve for increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity, with significant requirement on companies that pose risks to the financial system.”
- Designating “a nonbank financial company be regulated by the Federal Reserve if the council believes there would be negative effects on the financial system if the company were to fail or if its activities would pose a risk to the financial stability of the U.S.”
- “Break[ing] up large complex companies” if a company poses a grave threat to overall financial stability.⁴⁷

The FSOC, with the assistance of the Office of Financial Research will determine threats of systemic risk and then recommend action to the suitable regulatory agency to take the necessary steps in order to preserve the stability of the financial system.⁴⁸ Therefore, the FSOC acts like an early warning system. Whether they will be successful or not depends on their ability to monitor the whole financial system in a very comprehensive manner.⁴⁹

Second, the Dodd-Frank Act reforms the Federal Reserve by limiting its emergency lending authority, by expanding other powers, and by assigning it a new mandate: preserving the stability of the U.S. financial system.⁵⁰ The act, in order to support of the new mandate, created the position of “vice chairman for supervisions” to serve the Federal Reserve (the Fed) and to report to Congress semi-annually.⁵¹ The new position is to be filled by appointment of the President and subject to Senate confirmation.⁵² Over three years have passed since The Dodd-Frank Act was signed into law, yet this position remains to be filled.

The act allows for expansion of the Fed’s power to “better capture and regulate institutions and activities that can threaten the stability of the financial system.”⁵³ Previously, the Fed acted only as the supervisor of bank holding companies; now it has been granted increased authority over their banking

⁴⁷ United States Senate Committee on Banking, Housing & Urban Affairs.

⁴⁸ Krainer, 124.

⁴⁹ Evanoff and Moeller, 75-84.

⁵⁰ Krainer, 122.

⁵¹ Ibid., 122.

⁵² Ibid., 122.

⁵³ Evanoff and Moeller, 79.

and nonbanking subsidiaries.⁵⁴ It will also have authority over savings and loan holding companies which used to be under the purview of the now defunct Office of Thrift Supervision.⁵⁵ In addition, the Dodd-Frank Act authorizes the Fed to supervise nonbank financial institutions (investment banks and insurance companies for example) if the FSOC deems any to be of systemic importance.⁵⁶

The Dodd-Frank Act also requires the Fed to enforce greater prudential standards, including higher capital, leverage, and liquidity requirements according to the recommendations of the FSOC.⁵⁷ In addition, all SIFIs must develop orderly resolution plans, otherwise known as “living wills” in order to liquidate with the least amount of systemic impact.⁵⁸ If a firm’s resolution plan is determined jointly by the Fed and Federal Deposit Insurance Corporation (FDIC) to be unsound then the Fed has the authority to set stricter requirements and also restrict growth and limit specific activities.⁵⁹ The SIFI then has two years to submit a credible resolution plan; failing that, the Fed has the authority to designate the SIFI as a grave threat to financial stability.⁶⁰ At which point the FSOC, with a two-thirds vote, has the authority to require the offending company to divest.⁶¹

The Dodd-Frank Act attempts to improve financial stability through bold changes to the financial regulatory system; however these changes will also bring to light further challenges and potential problems. Major changes have occurred with the Federal Reserve, specifically the expansion of authority which brings into question the significance of this increased power and influence. Traditionally, the central bank’s independence has proven to be key in controlling inflation. The Federal Reserve was originally intended to serve as a “decentralized, joint banking venture, reined-in by checks

⁵⁴ Bernard Shull, “The Impact of Financial Reform on Federal Reserve Autonomy,” Levy Economics Institute of Bard College (2012): 6.

⁵⁵ Ibid., 6-7.

⁵⁶ Ibid., 7.

⁵⁷ Ibid., 7.

⁵⁸ Ibid., 7.

⁵⁹ Ibid., 7.

⁶⁰ Ibid., 7-8.

⁶¹ Ibid., 8

and balances within, and overseen, but not managed, by the government.⁶² The changes to the Federal Reserve leaves a lot of questions unanswered because the consequences of these changes have yet to be revealed. In the meantime the question of the central bank's independence is important and has everyone wondering about the impact of these changes.

One such unconventional measure, for example, was the Fed's effort to increase liquidity through swap lines with foreign central banks.⁶³ These central banks, needing to create liquidity for their financial institutions (that required dollar funding) swapped their currencies with the Fed for dollars in unlimited amounts.⁶⁴ According to the Federal Reserve's minutes of the October 29-30, 2013 meeting of the Federal Open Market Committee this supposedly temporary measure was turned into standing arrangements.⁶⁵ The Associated Press explained the action as follows: "Six of the world's leading central banks, including the U.S. Federal Reserve, say they will provide each other with ready supplies of their currencies on a standing basis, extending arrangements set up to steady the global financial system during post-2007 turbulence."⁶⁶ Originally the action was adopted as a temporary, emergency operation, but now has become a permanent rule which some question the wisdom of because lack of accountability at the Fed.⁶⁷

Another criticism in the wake of the financial crisis deals with the rule of law. The Fed created a special-purpose vehicle, Maiden Lane LLC I, to take toxic assets totaling \$30 billion from Bear Sterns to sweeten the deal for the JPMorgan Chase's acquisition. Then it created Maiden Lane LLC II & III to buy and hold more toxic assets from AIG Insurance in an effort to shore it up from collapse. According to Lawrence H. White "[t]here was no precedent, and no apparent legal authority in the Federal Reserve

⁶² Shull, 4.

⁶³ Frederic S. Mishkin, "Over the Cliff: From the Subprime to the Global Financial Crisis," *Journal of Economic Perspectives* 25 no. 1 (2011): 60.

⁶⁴ Ibid., 60.

⁶⁵ Pam Martens, "Fed Minutes Reveal a Dangerous Power Grab by New York Fed," Wall Street on Parade Blog (2013).

⁶⁶ Ibid.

⁶⁷ Ibid.

Act, for such special-purpose funding operations.”⁶⁸ The Fed failed to uphold the rule of law by not following the law as written, in a predictable manner and in accordance with established precedent.⁶⁹

End Too-Big-To-Fail and Taxpayer Bailouts: According to Mark Van Der Weide, a Senior Associate Director of the Federal Reserve System, taking on “too-big-to-fail” and threats to financial stability should be the central goals of the Dodd-Frank Act.⁷⁰ As far as Van Der Weide is concerned, in order to protect financial stability we must address the problems with “systemically important financial institutions”; however, he is quick to point out that “systemic risk can certainly be generated, and propagated outside of our largest financial firms.”⁷¹ He warns that systemic risk can reach across financial sectors with similar funding patterns that can easily be underestimated as risk, especially during cyclical euphoria.⁷² Another danger comes from what Van Der Weide describes as “systemic herds,” a collection of firms such as money market mutual funds that individually many not be systemic but are collectively.⁷³

Martin J. Gruenberg, chairman of the Federal Deposit Insurance Corporation (FDIC) describes a potential SIFI:

It is likely to be a firm with several business lines—perhaps commercial banking, capital markets, global asset management, and transaction services—and which operates across national borders. The corporate structure is likely to be a holding company with a parent at the top and multiple layers of subsidiaries. The number of subsidiaries will be in the hundreds, if not thousands. It is also likely that the structure of the legal entities within the company will not be aligned with the business lines. Additionally, intra-company and financial relationships will not be transparent.⁷⁴

With that description one can begin to better understand the level of complexity when dealing with the corporate structure of a SIFI and what it might take to break such a firm apart.

⁶⁸ Lawrence H. White, “The Federal Reserve and the Rule of Law, Testimony before the House Committee on Financial Services,” Mercatus Center, George Mason University (2013).

⁶⁹ Ibid.

⁷⁰ Mark Van Der Weide, “Implementing Dodd-Frank: Identifying and Mitigating Systemic Risk,” *Economic Perspectives* no. 3 (September 2012): 108.

⁷¹ Ibid., 108.

⁷² Ibid., 108.

⁷³ Ibid., 109.

⁷⁴ Martin J. Gruenberg, “Implementing Dodd-Frank: Orderly Resolution,” *Economic Perspectives* no. 3 (September 2012): 99.

Unfortunately, due to previous bail-outs, such as the rescue of Continental Illinois National Bank in 1984 and the consequent bail-outs that resulted from the Financial Crisis of 2007-2009, there exists a precedent which results in an implicit government guarantee.⁷⁵ The implicit guarantee in itself constitutes a moral hazard and reduces market self-discipline.⁷⁶ Evanoff and Moeller further point out that SIFIs “obtain a comparative advantage in the marketplace as a result of their perceived “too-big-to-fail status,” which lowers the risk premiums on their debt instruments.”⁷⁷ Another concern is the issue of inter-connectedness and its implication that it is not how large a financial institution is but how it is connected to other institutions, the threat being should one fail the potential exists for others to fail, basically triggering a domino effect of default, as became apparent with the collapse of Lehman Brothers in 2008.

The first line of defense provided by The Dodd-Frank Act is the creation of the Financial Oversight Board, which has the power to designate financial and nonfinancial institutions as SIFIs. Once designated as systemically important, SIFIs come under the Federal Reserve’s jurisdiction for stricter risk management, plus additional restrictions and requirements for liquidity and leverage.⁷⁸ Second, the act requires that SIFIs submit a “living will,” the basic plan for a rapid and orderly shutdown should the company default.⁷⁹ Evanoff and Moeller, explain the challenge of inter-connectedness and the purpose of a living will:

One of the major problems with resolving a large financial institution is the complex interconnectedness of the various elements of the organization. Affiliates and subsidiaries may be legally structured in a manner to achieve certain corporate objectives such as tax avoidance or regulatory arbitrage that may make the resolution process more difficult. With a living will in place, regulators can work with the SIFIs to restructure the organization and avoid these difficulties should resolution become necessary. Generally, the living wills are intended to provide the resolution authority with critical information on the firm’s organizational structure to aide in the resolution process.⁸⁰

⁷⁵ Evanoff and Moeller, 79.

⁷⁶ Ibid., 79.

⁷⁷ Ibid., 79.

⁷⁸ Ibid., 79.

⁷⁹ United States Department of the Treasury. *The Financial Crisis Five Years Later...*

⁸⁰ Evanoff and Moeller, 80.

The nature of interconnectedness among financial institutions poses a threat to the overall system if even one SIFI should fail. The “living will” theoretically acts as a deterrent and is an attempt at cycle-proof regulation that Raghuram G. Rajan discussed in his paper.⁸¹

But what if, despite all efforts to the contrary, a SIFI should fail? Recognizing that danger the Dodd-Frank Act proposes to eliminate “too-big-to-fail” and taxpayer-funded bailouts with an alternative failure resolution process known as the Orderly Liquidation Authority (OLA).⁸² The Act confers the authority of OLA via the Federal Deposit Insurance Corporation (FDIC) to dismantle a failing SIFI.⁸³

As explained by Evanoff and Moeller, the Secretary of the Treasury decides if a SIFI is in danger of default, then makes the recommendation as to whether or not the FDIC should take the company into receivership.⁸⁴ Once this process is initiated the Dodd-Frank Act imposes significant restrictions:

- The management and board of directors that were responsible for the failure of the firms must be removed.
- The priority of claims in the resolution process should be adhered to in allocating firm losses—equity holders will not receive anything until all the other creditors, including the FDIC, have been repaid.
- The FDIC will not take an equity position with the failing firm.
- No taxpayer funds are to be used to prevent the firm from being liquidated. Instead, the industry, perhaps through special assessments, will incur any losses from the resolution process.⁸⁵

This extreme resolution process, it is hoped, will act as a deterrent in itself since it basically proposes nationalization of the SIFI as the FDIC acts to dismantle and liquidate assets.

Martin J. Gruenberg of the FDIC acknowledges that the resolution of such large financial firms with complex corporate structures differs greatly from the resolution process of a single insured bank and proposes that by placing only the parent holding company into receivership would lessen the likelihood

⁸¹ Rajan, 397 - 402.

⁸² Evanoff and Moeller, 79 - 80.

⁸³ United States Senate Committee on Banking, Housing & Urban Affairs.

⁸⁴ Evanoff and Moeller, 78.

⁸⁵ Ibid., 78 - 79.

of “disruption and loss of franchise value” if the inter-relationships among the subsidiaries were to cease.⁸⁶ Also Gruenberg points out that there has been a concerted effort to provide market accountability in that the new resolution authority does not protect creditors or counterparties by providing insurance or credit protection against potential losses.⁸⁷

Furthermore, the new resolution authority comes with access to a new source of liquidity support provided by the Dodd-Frank Act: the Orderly Liquidation Fund (OLF), located in the Treasury Department.⁸⁸ The FDIC can borrow funds from OLF to assist in the liquidation procedure and to cover any losses incurred during the resolution process.⁸⁹ Congressional Budget Office (CBO) estimates that direct spending for potential liquidation activities, including recoveries from the sale of assets but excluding revenues from assessments will be \$26.3 billion through 2020.⁹⁰ The revenues mentioned here would come from fees assessed among the remaining SIFIs in the industry. Basically they will be penalized for the failure of one another.

The Committee on Financial Services acknowledged that even though the act claims to end bailouts of “too-big-to-fail” firms, the act nevertheless grants the FDIC permission to borrow taxpayer funds in the form of allocations set aside specially for the OLF with the intention of paying off creditors of any failed SIFI.⁹¹ The majority recommended repealing OLA; however, the minority concluded that to repeal the OLA “would expose the economy to additional uncertainty and instability.”⁹² It is important to note that the FDIC has yet to finalize all the rule making that would affect the process of its receivership of a failing SIFI.

⁸⁶ Gruenberg, 99 - 100.

⁸⁷ Ibid., 100.

⁸⁸ Ibid., 100.

⁸⁹ Congressional Budget Office, “Review of CBO’s Cost Estimate for the Dodd-Frank Wall Street Reform and Consumer Protect Act,” Statement of Douglas W. Elmendorf, Testimony before the Subcommittee on Oversight and Investigations Committee on Financial Services, U.S. House of Representatives, Washington, D.C., (2011).

⁹⁰ Ibid.

⁹¹ Committee on Financial Services, “Views and Estimates of the Committee on Financial Services on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2014,” (Report), Washington, D.C., (2013).

⁹² Ibid.

Consumers and Investors Protection: In light of the moral hazard and asymmetrical information failures, the Dodd-Frank Act created another new agency called the Consumer Financial Protection Bureau (CFPB). This new agency has “the authority to ensure American consumers get the clear, accurate information they need to shop for mortgages, credit cards, and other financial products, and protect them from hidden fees, abusive terms and deceptive practices.”⁹³ CFPB merges consumer protection responsibilities previously handled by the Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, Federal Reserve, National Credit Union Administration, the Department of Housing and Urban Development, and the Federal Trade Commission.⁹⁴

The new agency deals with predatory lending practices and misleading products, as well as imposing particular underwriting standards, requiring that firms performing securitization retain at least 5 percent (considered “skin in the game”) of the credit risk and increase rating agency regulations.⁹⁵ CFPB is an independent entity located within and funded by the Federal Reserve. Robert Krainer stated that it is typical for financial crises to bring to light a number of “sharp, if not outright fraudulent practices” and the financial crisis of 2007-2009 was no exception.⁹⁶ Such practices came from contractual terms of mortgages that included 2/28 adjustable rates and prepayment fees for example.⁹⁷ There were abuses with payday loans as well as hidden credit card fees.⁹⁸ CFPB now has the authority to regulate firms that previously never were, such as consumer reporting agencies, debt collection agencies and payday lenders.⁹⁹

Additionally, CFPB has the authority to regulate a number of consumer financial products (but not all) that formerly were under the control of the Federal Reserve, FDIC, and the Office of the

⁹³ United States Senate Committee on Banking, Housing & Urban Affairs.

⁹⁴ Ibid.

⁹⁵ Krainer, 130.

⁹⁶ Ibid., 123.

⁹⁷ Ibid., 123.

⁹⁸ Ibid., 123.

⁹⁹ Ibid., 123.

Comptroller of the Currency as well as prohibit and establish penalties for unfair lending practices.¹⁰⁰

The Committee on Financial Services reported that CFPB “has successfully recovered hundreds of millions of dollars for consumers from credit card companies and debt relief services through its enforcement authority and working with state attorneys general.”¹⁰¹ It is hoped that this new agency will continue to provide needed consumer protection but more time and studies are needed to ascertain a cost-benefit analysis to determine its effectiveness.

IMPACT

It has been over six years since the beginning of the financial crisis and over three years since the Dodd-Frank Act was enacted. So what impact has Dodd-Frank had on the economy? The answer to that question is debatable because one of the act’s greatest challenges to being effective is its slow rate of implementation. Not all of the rules have been implemented and some have yet to be developed and proposed. As of November 1, 2013 only 162 of the 398 (41%) total rulemaking requirements have been achieved, 110 (28%) of the 398 total rulemaking requirements have missed their deadlines and 60 out of 398 (15%) had deadlines to submit proposals for new rules but missed them.¹⁰² The remainder (17%) have deadlines that fall into the future.¹⁰³

Delays in the implementation of the many rules continue to expose the economy to the very dangers the Dodd-Frank Act is supposed to prevent. Having the policy fully implemented is essential as it stands now it is hard to evaluate the act’s full impact on the financial industry. David L. Weimer and Aidan R. Vining explain that “[a]dopted policies gain force through implementation.”¹⁰⁴ They also refer to Eugene Bardach’s metaphor for implementation: the process of assembling and keeping in place all

¹⁰⁰ Ibid., 123.

¹⁰¹ Committee on Financial Services, *Views and Estimates...*

¹⁰² Davis Polk & Wardwell LLP, "Dodd-Frank Progress Report," Last modified November 2013.

¹⁰³ Ibid.

¹⁰⁴ David L. Weimer and Aidan R. Vining, *Policy Analysis: Concepts and Practice, 5th Edition*. (Longman: Pearson Education, Inc., 2011): 186.

the elements needed for a machine.¹⁰⁵ If the Dodd-Frank Act is like a machine, then it is missing some vital parts! The authors take the metaphor a little further by discussing design, an important element to function, and compare it to theory:

Of course, just as a machine may not work as intended if its design is flawed, a policy based on an incorrect theory may also produce unintended consequences. Yet, an effective design (correct theory) is only a necessary, but not a sufficient, condition for a working machine (effective policy). If necessary parts (essential policy elements) are either not available or unreliable, then the machine (policy) will not work effectively.¹⁰⁶

I would argue since such radical changes have been wrought under the Dodd-Frank Act that the “design” or theory being applied have yet to be fully tested. All the pieces of the machine have yet to be put together to see if it can function as intended. Weimer & Vining make one more important point: “The essence of the implementation problem lies in the distribution of necessary elements. The greater the potential for either persons or organizations to withhold necessary contributions, the greater is the possibility of failure.”¹⁰⁷ Unfortunately the task being given the regulators will be a very lengthy process. As Evanoff and Moeller point out “...many parts of Dodd-Frank Act lack specificity as to how they are to be implemented, giving regulators significant discretionary authority to develop and implement rules.”¹⁰⁸

Regarding the act’s impact on the overall economy, the Executive Office of the President painted an optimistic picture when its report “The Financial Crisis: Five Years Later” was published in September 2013:

America has fought our way back. Because of these tough choices, over the past three and a half years, our businesses have created seven and a half million new jobs. Manufacturers are adding jobs for the first time since the mid-1990's. We generate more renewable energy than ever, and our exports are at all-time highs. Health care costs are growing at the slowest rate in 50 years – and our deficit has fallen by 50% since the President took office. Through Wall Street Reform, the President has laid the foundation for a better future. The passage of the Dodd-Frank Act has strengthened the recovery and helped prevent a future crisis,

¹⁰⁵ Ibid., 186.

¹⁰⁶ Ibid., 186.

¹⁰⁷ Ibid., 186.

¹⁰⁸ Evanoff and Moeller, 77.

implementing some of the strongest Wall Street reforms and consumer protections in our nation's history.¹⁰⁹

However, the United States Department of the Treasury's report, "The Financial Crisis Five Years Later - Response, Reform, and Progress" (dated September 2013) came with a more realistic nod to the work yet to be done and a warning:

As we approach the five-year anniversary of the height of the crisis, the financial system is safer, stronger, and more resilient than it was beforehand. We are still living with the broader economic consequences, and we still have more work to do to repair the damage. But without the government's forceful response, that damage would have been far worse and the ultimate cost to repair the damage would have been far higher. The financial crisis reminds us that we must remain vigilant to emerging risks in the system. The financial system is dynamic and firms are innovative. And as sources of risk change, regulation and oversight must keep pace.¹¹⁰

The consequences of the financial crisis of 2007-2009 were severe. The country plummeted into a deep recession which it is still trying to recover from, 8.8 million jobs were lost and \$19.2 trillion (in 2011 dollars) household wealth disappeared.¹¹¹ In addition, the United States Government Accountability Office (GAO) stated in 2013 that "[s]tudies estimating the losses of financial crises based on lost output (value of goods and services not produced) suggest losses associated with the recent crisis could range from a few trillion dollars to over \$10 trillion."¹¹² The GAO report also acknowledged that "[s]ome studies suggest the crisis could have long-lasting effects: for example high unemployment, if persistent, could lead to skill erosion and lower future earnings for those affected."¹¹³

The U.S. Bureau of Labor Statistics reported the trend for the labor force participation rate is even more worrisome with the population age 16-44 declining and age 55 and over increasing. While unemployment has declined to 7.3 percent from its October 2009 peak of 10 percent, it is still too high,

¹⁰⁹ Executive Office of the President. "The Financial Crisis: Five Years Later" (Report). Washington, D.C., (2013).

¹¹⁰ United States Department of the Treasury. *The Financial Crisis Five Years Later...*

¹¹¹ United States Department of the Treasury. *The Financial Crisis Response in Charts.*

¹¹² United States Government Accountability Office. *Financial Regulatory Reform: Financial Crisis Losses and Potential Impacts of the Dodd Frank Act.* Washington, D.C., (2013).

¹¹³ Ibid.

and long-term unemployment and its consequences remain a concern.¹¹⁴ The indications of the current state of the economy, though improving, predict a very slow pace of recovery.

Challenges to Financial Stability Will Continue Under the Dodd-Frank Act

In this section I discuss the failures that will pose continued challenges to the financial industry despite or because of the Dodd-Frank Act. Until the act's rulemaking process has been completed and the act has been fully implemented the financial system is still at risk from adverse effects of negative shocks. The greater worry, of course, is that even a fully implemented act will not be enough to stave off another economic downfall, in light of a weakened economic environment. Additionally, it must be recognized that the act is failing sufficiently to address critical failures at play, such as systemic risk, moral hazard, and asymmetrical information.

Systemic risk: The market failure that became a critical problem during the financial crisis was systemic risk, and yet it remains a very real threat despite the efforts of the Dodd-Frank Act thus far. The problem is that individual firms have little to no incentive to manage themselves for systemic risk.¹¹⁵ The Dodd-Frank Act's solution helps to deal with the cost of the negative externality of systemic risk by imposing stricter regulations and setting in place a resolution process, but not all the rules are in place to handle this eventuality yet. The act, in my opinion, does not allow for sufficient market self-discipline and correction. There is not enough "skin in the game" to discourage the unintended consequence of moral hazard.

Moral hazard: This is an insidious and prevalent problem. With the creation of 'too big to fail' institutions built themselves up secure in the knowledge that due to their significance the government would not allow them to fall.¹¹⁶ There was no market correction for excessive risk-taking among these firms. This is still a troubling problem, as Richard W. Fisher noted: "[t]here is a great deal of moral

¹¹⁴ United States Department of the Treasury. *The Financial Crisis Five Years Later....*

¹¹⁵ Richardson, 87.

¹¹⁶ Biedermann, 315.

hazard at all levels of decision-making in our current financial system.”¹¹⁷ Unfortunately the moral hazard problem remains, insidious and prevalent. The other areas that the act could help improve have yet to be determined by the finalized rules such as the credit rating agencies and O-T-C derivatives.

Asymmetrical information: This problem will continue to be challenging due to its relationship with the moral hazard issue. There will always be some who have insider information; however, what they choose to do with advantageous information is a matter of ethics and contributes to moral hazard when choices are made for profit’s sake without any consideration to the overall safety of the financial system.

Mispriced government guarantees: This is a term coined by Matthew Richardson which describes what he considers to be mispriced government guarantees in the financial system, “such as deposit insurance, too-big-to-fail subsidies, and government-sponsored enterprise (GSE) debt subsidies.”¹¹⁸ Unfortunately, one of the unintended consequences of federal guarantees is that they encourage imprudent risk taking, which ultimately may lead to instability in the very system that the safety net is designed to protect.¹¹⁹

Regulatory/Political Capture: Due to the nature of how the government functions individuals with the responsibility to address problems in the financial industry will inadvertently find themselves under the influence and pressure of interest groups. These interest groups have specific agendas and will attempt to wield their power on decision makers in order to further their aims. The financial industry has a very wealthy, well-connected financial lobby that favors less regulation and oversight and has been very active in voicing its opinions to policy makers and regulators. According to Simon

¹¹⁷ Richard W. Fisher, “Correcting ‘Dodd-Frank’ to Actually End ‘Too Big to Fail.’” Statement before the Committee on Financial Services, U.S. House of Representatives, Hearing on Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts. Washington, D.C., (2013).

¹¹⁸ Richardson, 85-97.

¹¹⁹ Ibid., 85-97.

Johnson, it is working at “convincing people that more finance is good, more unfettered finance is better, and completely unregulated finance is best.”¹²⁰

ALTERNATIVE POLICY IDEAS & STRATEGIES

In this section I discuss some alternative policy ideas and strategies that academics and economists are contemplating and debating. One strategy I highly recommend was proposed by Raghuram G. Rajan, a theory he terms “Cycle-Proof Regulation.”¹²¹ He warns that “we reform under the delusion that the regulated –and the markets they operate in—are static and passive and that the regulatory environment will not vary with the cycle.”¹²² At the bottom of the cycle we tend to over regulate, and at the top, conversely, we tend to deregulate—“to the point of maximum danger to the system.”¹²³ Ergo, any policy idea or strategy should take into consideration the nature of the business cycle. In fact, the Dodd-Frank Act did exactly that with the ‘living will’ requirement of the new SIFI resolution process.

Larry Summers, former U.S. Treasury Secretary stated that “you should take the moment of crisis and seize it as an opportunity to clean up and fix the financial system, addressing the underlying incentive problems that brought forth the crisis.”¹²⁴ He also stated “that no sustainable financial system could be based on the expectation of unconditional bailouts. The big banks today, I can assure you, have an expectation of bailouts without any conditions.”¹²⁵ Much more work needs to be accomplished in regards to addressing the incentives that led to the financial crisis and the idea of taxpayer bailouts must be eliminated. Firms acting in risky investment strategies must be held accountable for the threat they pose to financial stability.

¹²⁰ Johnson, 159-168.

¹²¹ Rajan, 397 - 402.

¹²² Ibid., 400.

¹²³ Ibid., 401.

¹²⁴ Johnson, 161.

¹²⁵ Ibid., 161.

According to Richard W. Fisher, the financial system is very lopsided, with less than a dozen banking conglomerates controlling up to nearly 70% of the assets in the banking industry.¹²⁶

Unfortunately the threat of systemic risk remains and has the potential to sow catastrophic financial disaster, not only to the U.S. economy but to the global economy as well. The interconnectedness of these financial institutions is a global phenomenon.

The Volcker Rule, an amendment to the Dodd-Frank Act attempted “to separate financial intermediation in both its commercial and investment banking functions from the more speculative business of proprietary trading, and ownership in both hedge funds and private equity funds,” but through the political process ended up being weakened into only “limitations placed on banks engaging in these trading activities and that limitation was spread out up to 7 years in the future.”¹²⁷ After it became apparent that the Volcker Rule would not succeed in reigning back big banks and in light of their continued threat of systemic risk, another policy proposal entered the arena for deliberation, “down-size mega banks.”¹²⁸ Richard Fisher, of the Dallas Federal Reserve proposes that “too-big-to-fail” financial institutions be restructured into multiple business entities.”¹²⁹ As he explains it, “only the resulting downsized commercial banking operations—and not shadow banking affiliates or the parent company—would benefit from the safety net of federal deposit insurance and access to the Federal Reserve’s discount window.”¹³⁰ He believes that it is vital to address institutional size in order for the threat of failure to be believable; this would allow for marketplace discipline. As Fisher describes, “knowing where the federal government guarantees begin and end would properly realign incentives and reinvigorate a degree of creditor discipline that has been dormant at large, complex financial institutions for far too long.”¹³¹

¹²⁶ Richard W. Fisher, “Ending ‘Too Big to Fail,’ Remarks before the Conservative Political Action Conference,” (Speech). National Harbor, MD, (2013).

¹²⁷ Krainer, 126.

¹²⁸ Fisher, 3-5.

¹²⁹ Ibid., 3-5.

¹³⁰ Ibid., 3-5.

¹³¹ Ibid., 3-5.

Another proposal is that systemic risk should be treated like a negative externality. The full costs of an externality are not borne by parties in the transaction unless there are markets to appropriately price the externality.¹³² Typically, the markets for externalities are missing (think of carbon emissions, for example) and so, to, is the invisible hand operating through price to produce externalities at the efficient level.¹³³ According to the authors of *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* “[e]conomists’ preferred solutions to this kind of market failure are generally to employ what are called Pigouvian taxes.”¹³⁴ The authors maintain “[s]uch taxes are usually the least invasive way to remedy a market failure, because they do not require heavy-handed government intervention into the specific decisions made by households and firms. In the context of the financial crisis, these would take the form of taxes on financial firms that rise with their systemic risk contributions.”¹³⁵ Further they point out that the tax would provide revenue for the government to reduce other taxes or contribute to the costs dealing with SIFI resolutions.¹³⁶

CONCLUSION

It has been six years since the financial crisis began in 2007 and three years since policy makers responded by enacting the Dodd-Frank Act of 2010 in hopes of addressing the problems of a broken financial regulatory system which were revealed in the aftermath of the crisis. Most importantly, the act is an effort to provide the public with peace of mind, that the government was willing and able to respond to the crisis and will see to financial stability in the future. But does the act really accomplish this?

At this moment in time, I do not believe it does. If it is to be believed that the crisis resulted primarily from reckless behavior of the world’s largest banks then they clearly remain a threat. It has yet to be determined if the partially enacted Dodd-Frank Act will provide enough disincentive for these

¹³² Acharya et al., 121-124.

¹³³ Ibid., 121-124.

¹³⁴ Ibid., 121-124.

¹³⁵ Ibid., 121-124.

¹³⁶ Ibid., 121-124.

large, complex institutions to curb systemically threatening activity. I would argue that this is not the case because there remains an implicit guarantee that any failing SIFI would not be allowed to fail, that the government will step in to prevent a total collapse. To date, the FSOC is compiling an ever growing list of not only financial SIFIs but also other nonfinancial institutions that they deem a potential threat. The restrictions they will enforce on these entities will eventually be very strict, but until all the rules are finalized it cannot yet be determined if the act will have a positive or negative impact. If the restrictions are too strict, not only the industry, but the overall economy suffers. Then there will be tremendous pressure on law makers to roll back regulations again to a degree that can be dangerous.

It is hoped that even though the Dodd-Frank Act was all about putting out fires, it still has the intention and potential to restructure the financial system for the better. However, its complexity and rate of implementation might be its undoing. In the meantime, efforts to change or influence the rule making process are well under way. Political and regulatory agency capture will have a toll on the ultimate effectiveness of this act.

A concerted effort must be made going forward to provide a regulatory framework that is less-susceptible to the business cycle's whim. The system must be flexible enough in the highs and lows of 'boom and bust' cycles that it can provide enough freedom for growth yet restrain markets just enough so they do not cause catastrophic harm. All efforts should be made for market participants to be accountable and responsible for their actions. If they choose to perpetrate risk at levels that threaten the overall economic well-being of this country they should pay a price for that choice, not be offered guarantees of financial support. And regulations must endeavor to find the right balance in order to offer safety and stability yet encourage innovation and growth.

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